FORMAL AND INFORMAL INSTITUTIONAL LEGACIES AND INWARD FOREIGN DIRECT INVESTMENT INTO FIRMS: EVIDENCE FROM CHINA

ABSTRACT

This paper explores the influence of informal institutional legacy on contemporary foreign direct investment (FDI). This study is situated in the context of China's Treaty Port Era (1842–1943). Hypotheses are posited and tested related to how the treaty port policies and overseas Chinese communities of cities established during that period created formal and informal institutional legacies that positively influence the likelihood and volume of contemporary inward FDI firms receive. This research suggests despite and because of the Cultural Revolution's traumatic shock, informal institutions helped formal institutions morph into informal rules and thus created a lingering legacy effect. Drawing on a longitudinal sample of Chinese firms' data and historical materials that provide information about treaty ports and overseas Chinese communities, this study finds supporting evidence that informal institutional legacy is important for contemporary FDI and brings history back into the international business literature. This study provides practical implications by suggesting that, given the increasing turbulence and uncertainties in emerging markets and transnational economies, building and maintaining connections with transitional community actors of these countries could take advantage of the informal institutions to mitigate risks and sustain international business activities. International investors could also benefit by investing in locales with rich transnational community connections.

Keywords: informal institution, formal institution, inward foreign direct investment (FDI), history, China, institutional change

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INTRODUCTION

How do informal institutions affect country-level inward foreign direct investment (FDI) flows? This question has attracted growing international business research interest. Informal institutions are socially shared unwritten rules that are created, shared, and enforced outside official channels (Helmke & Levitsky, 2004; Seyoum, 2011). North argued that informal institutions are "embodied in customs, traditions, and codes of conduct" (1990: 6), and they are formed to prescribe what economic and investment behaviors are considered desirable and appropriate (Holmes, Miller, Hitt & Salmador, 2013; Reed, 1996). Previous research has mainly regarded contemporary national culture as an informal institution that affects FDI (Brouthers & Brouthers, 2001; Buckley, Clegg & Wang, 2010; Shenkar, 2001); however, it has devoted less attention to exploring how historical informal institutions affect international business activities.

Nevertheless, researchers have documented that historical informal norms and ties have enduring effects on international business in many countries. For example, Greif (1993; 1989) showed Mediterranean traders have relied on informal norms of expectation and reputation to reinforce ethnic coalitions, and they motivated traders to adhere to contracts and sustain trade relationships. Researchers have also shown former colonial ties created historical ties that influenced international business for even hundreds of years after those ties were broken. For example, Makino and Tsang (2011) showed historical informal ties between Vietnam and colonizer countries still affect foreign firms' entry decisions. Other researchers demonstrated China's former colonial ties have also positively contributed to bilateral trade because of familiarity and ethnic connections (Gao, 2003; Rauch & Trindade, 2002).

These studies have contributed to understanding the role historical informal norms and ties have played in affecting international business. However, we know less about the mechanisms by which historical informal institutions might create independently and jointly with formal institutions (Makino &

Tsang, 2011) institution-based location advantages that continuously affect the distribution of contemporary inward FDI.

This study examines how informal institutions that have been created in and carried out by transnational ethnic communities continuously affect contemporary inward FDI. It resonates with the views of scholars such as Dahles (2010), Djelic and Quack (2010), Gregorič, Rabbiosi and Santangelo (2020), and Li, Hernandez, and Gwon (2019) that transnational ethnic communities facilitate institutionalization and reproduction of informal institutions because the economic actors within the community embody "customs, traditions, and codes of conduct" (North, 1990: 6). This research explores how informal institutions help formal institutions morph and evolve into informal rules to create a continuous legacy effect. To better understand the mechanisms of the enduring effect of historical informal institutions on contemporary international business, this study further explores how these legacies might be disrupted by a traumatic shock (Klüppel, Pierce & Snyder, 2018). For example, a political shock, such as a communist revolution, can transform institutions, disrupt networks, and affect social and business exchanges (Siegel, Licht & Schwartz, 2011, 2013). However, as Williamson (2000) suggested, the deep embeddedness of informal institutions in communities may make them resistant to external disruptions. In light of these considerations, this study investigates these questions: How does informal institutional legacy affect contemporary inward FDI distribution? How is this effect shaped by a political traumatic shock?

To answer these two research questions, this study focuses on the Chinese context for two reasons. First, China has experienced a long colonial history (from 1840 to 1943) in which informal institutions such as codes of conduct and relational norms developed and were followed by Chinese traders, merchants, and an intermediary class; these continuously facilitated collaboration and international transactions. As Liu pointed out, "through formulating and sustaining proper codes of behavior and supporting Chinese cultural values" (2000:112), Chinese traders and social organizations created such informal institutions that sustained international business transactions over time. Second, China's Cultural

Revolution (from 1966 to 1976) was a political shock that disrupted inward FDI and had enduring effects on international business activities. This study specifically investigates how the Treaty Port Era (from 1842 to 1943), a time when China granted foreign powers preferential access to certain Chinese ports (Jones & Khanna, 2006), created formal and informal institutions in Chinese cities that have affected international business activities ever since and persistently influenced contemporary inward FDI therein.

For this purpose, treaty port policies are regarded as formal institutions stemming from the treaty port agreements and trade laws that affected international business laws and regulations in China. Functioning as a transnational ethnic community (Li, Hernandez & Gwon, 2019), the overseas Chinese community (Gao, 2003; Qiu, 2005) has created a social environment for Chinese traders, merchants, and the intermediary class to develop and share social meanings and unwritten rules to guide transactions and interactions. It appears this legacy has been developed and carried on through the mechanisms of prescribing codes of business conduct and enforcing *guanxi* (an interpersonal relationship) to secure trust and reciprocal exchanges within the community.

Further, to study how traumatic political shock disrupts formal and informal legacies, this study examines how the Communist Party of China's (CPC's) takeover in 1949 altered these legacies because the government/CPC (the single-party state entity) took many steps to abolish the deep foreign influence established in some locations during the Treaty Port Era. These activities were most salient during the traumatic shock of the Cultural Revolution (from 1966 to 1976) when the government turned inward and worked to eradicate all foreign influence (Marquis & Qiao, 2018). This study collected panel data from the Annual Survey of Chinese Industrial Firms and historical information about the Chinese cities where these firms are now located. It provides evidence of the persistent influence of informal institutions on contemporary inward FDI. The findings indicated that although the Cultural Revolution severely disrupted the effects of formal institutional legacy, it affected informal institutional legacy to a lesser extent, perhaps due to the compensatory efforts made by the overseas Chinese community to restore the broken historical link.

This study offers three major contributions. First, it shows how historical informal institutions play a crucial role in sustaining international business activities over time. Second, by suggesting their function in translating and internalizing formal institutions into business practices, it enriches our understanding of the mechanisms by which informal institutional legacy affects international business activities. Third, extending from the Chinese context, this study offers implications for understanding the enduring effects of informal institutions in contexts, such as emerging markets and transnational economies, where institutional upheavals have taken place.

THEORY AND HYPOTHESES

Theoretical background

The function of institutions is to reduce economic uncertainty and transaction costs by establishing a stable structure for exchange (North, 1990). This is the core premise of rational choice institutionalism, which portrays institutions as the result of purposive actions in generating cooperation and pursuing common interests (Hall & Taylor, 1996; Williamson, 1985). Actors create institutions to structure interactions by "affecting the range and sequence of alternatives on the choice agenda" (Hall & Taylor, 1996: 945) and by providing enforcement mechanisms to facilitate collective action for better economic outcomes (Williamson, 1985). Based on the degree to which their rules are structured, scholars differentiate formal and informal institutions (North, 1990), referring to formal institutions as written rules and informal as unwritten ones. However, both institutional types provide incentives and sanctioning mechanisms to enforce compliance and satisfy collective interests (Helmke & Levitsky, 2004； Holmes et al., 2013).

Although rational choice institutionalism provides insights into understanding the origins and benefits of institutions, it needs to be integrated with the path dependence perspective to explain why institutions persist and have enduring effects (Hall & Taylor, 1996). Developed in historical economics literature (Arthur, 1994; David, 1985), this perspective argues temporally remote events can determine outcomes through phases of path formation and lock-in (Sydow, Schreyögg & Koch, 2009). In the

formation phase, the decision to reproduce a particular choice can be facilitated by a self-reinforcing process with an increasing utility return. In the lock-in phase, this focal choice and action pattern are replicated and consolidated, leading the whole setting into a lock-in in which alternative choices and actions become less feasible due to switching costs and sunk costs. Thus, combining rational choice institutionalism and the path dependence perspective can help us better understand both the creation and persistent influence of institutions: actors create formal and informal institutions to satisfy their interests, and due to self-reinforcing process facilitated by increasing returns, these institutions become "carriers of history" (David, 1994) that maintain existing rules over time.

In an international business context, informal institutions such as traditions and shared norms and meanings can coordinate exchanges and facilitate transactions via mechanisms of trust, networks, and reputation (Cuypers, et al., 2020; Seyoum, 2011). Actors construct ethnic community values, norms, and beliefs to prescribe behaviors and enforce sanctions in order to pursue collective interests in transactions and investments (Greif, 1989; Greve & Rao, 2012; Wickström & Landa, 2018). Informal insitutions carried by communities and networks can create and reinforce a path dependent trajectory in trade and exchange (Deng, Delios & Peng, 2020) because they generate increasing returns, resolve exchange problems, and have great survival tenacity over time.

Scholars have also been paying increasing attention to the interaction between formal and informal institutions. For example, researchers acknowledge formal institutions are general parameters that cannot cover all contingencies (Helmke & Levitsky, 2004). However, informal institutions can fill the voids in affecting FDI inflows (Holmes et al., 2013; Seyoum, 2011) and might facilitate the evolution of formal ones to create a continuous effect on business activities (Scott, 2008; Williamson, 2000). This evolution could be observed in countries with emerging markets or transitional economies in which the government or another political regime intentionally demarcates a new period in sharp contrast to the past and actively aims to dislodge legacies (Klüppel et al., 2018; Newman, 2000). Although formal institutions are subject to change of political regime, informal institutions might help them to be morphed into informal rules to

have continuous effects on economic transactions (Scott, 2008; Williamson, 2000). Thus, this study explores the role of informal institutions and how they may transform formal institutions to continuously affect international business activities over time, despite external shocks. This paper seeks to answer two questions: How does informal institutional legacy affect contemporary inward FDI distribution? How is this effect shaped by a political traumatic shock?

Formal and informal institutional legacies in the Treaty Port Era

Motivated by the existing research lacunae, this paper attempts to understand how formal and informal institutions that originated during China's Treaty Port Era created enduring influence on contemporary inward FDI distribution, and how a traumatic shock might affect these effects. The Treaty Port Era (from 1842 to 1943) left a set of persistent legacies in China because of path dependence mechanisms. The first is a *formal* institutional legacy created by treaty port policies, stemming from the treaty port agreements and trade laws that affected international business laws and regulations in China. The second is an *informal* institutional legacy, the unwritten rules and social meanings created, shared, and carried out by Chinese traders, merchants, and the intermediary class within the overseas Chinese community to guide transactions and interactions. This legacy is reflected in the business conduct codes that have been prescribed by Confucian ethics and deposited over time and in *guanxi* practice that has been enforced to secure trust and facilitate reciprocal exchanges. During the period of increasing internationalization, China was affected not only by the importation of Western institutions but also by Chinese traders who went out into the world but still maintained strong ethnic connections with their hometowns. As a result of the increasing return and reinforcing process (Sydow et al., 2009), cities that had been exposed to treaty port policies and the informal institutional legacy carried out by overseas Chinese communities were more likely to develop institution-based location advantages, and firms located in those cities were more likely to "lock in" to these advantages of attracting and receiving FDI. Thus, as carriers of history (David, 1994), both the treaty port policies and the informal institutions could create path dependent legacies (Hypotheses 1 and 2).

Furthermore, informal institutional legacy carried on by the overseas Chinese community may mediate the positive relationship between formal institutional legacy and contemporary inward FDI (Hypothesis 3). However, formal institutions may be more subject to external shock, such as the Cultural Revolution (from 1966 to 1976), and informal ones may be more resistant to the shock. This suggests external shock may have a different moderating role on the relationship between formal and informal institutional legacies and contemporary FDI (Hypotheses 4a and 4b). The full theoretical model is shown in Figure 1, and the hypotheses are developed after some discussion.

---- Insert Figure 1 about here ----

Formal institutional legacy created by treaty port policies

After the first Opium War (between 1840 and 1842) ended and the Treaty of Nanking was signed in 1842, China was forced to abandon a seclusion policy that had previously cut off international trade. Foreign powers required the Chinese government to open certain cities, including Guangzhou, Ningbo, Fuzhou, Xiamen, and Shanghai, to foreign traders and investors to conduct business and international trade. The system, which later expanded to 66 Chinese cities (Fung, 1987), was "a semi-permanent form of Western intervention in Chinese life" (Fairbank, 1970: 411) and set the pattern for foreign commercial penetration into China. The treaty port system became the bedrock on which foreign commercial and financial interests in China were governed, encompassing contract enforcement, transparent rules, and predictable jurisprudence (Fung, 1987). In treaty ports with extraterritoriality, foreign citizens were exempted from Chinese law, and it was mandated foreign merchants in China solve commercial disputes by applying Western commercial laws, rather than Chinese laws. The Chinese government benefited from the business and city development of this era (Keller, Li & Shiue, 2011) and therefore complied with the treaty port policies. Thus, exposure to the formal institutions established by Western powers in Chinese treaty port cities might have created positive returns and reinforcing effects (Sydow et al., 2009) for these cities to attract international business resources by giving firms located in these cities the advantage of receiving more FDI than firms located in cities without such a formal institutional legacy.

Three points can be made regarding treaty port policies' lingering effect. First, treaty port policies were initially imposed by foreign powers to gain access to China to pursue business interests; this formal legacy helped reduce the formal institutional distance between the host regions and the investors' home countries. Formal institutional distance refers to the level of dissimilarity in laws, regulations, and practices between host and home institutions (Dikova, Sahib & van Witteloostuijn, 2010; Xu & Shenkar, 2002). A high degree of formal institutional distance creates a wide variety of obstacles to FDI, such as high transaction costs and uncertainties, misunderstandings of local laws, and difficulties in transferring business practices (Gaur & Lu, 2007; Kostova et al., 2020; Zaheer, 1995). However, historical events can shorten the institutional distance and increase local attractiveness, thus increasing foreign investment (Shinkle & McCann, 2014). For example, Makino and Tsang (2011) showed the formal agreements and treaties between Vietnam and France during the colonial period still influence inward FDI in Vietnam because they help both sides overcome institutional barriers by reducing uncertainties and costs in business transactions.

Second, the enforcement of treaty port policies helped foreign merchants and investors legitimize business and investment by exposing local Chinese residents to Western institutions that were maintained even after the Treaty Port Era. For example, Western countries established churches and sent missionaries to China during the Treaty Port Era; this enhanced local educational attainment and improved health conditions (Bai & Kung, 2015), and such institutions garnered goodwill from local residents (Chen, Wang & Yan, 2013). Studies have shown that after China reopened its doors to the outside world in 1978, cities with churches established before 1920 attracted more foreign investors, who contributed to economic growth (Bai & Kung, 2015). Other institutions that persisted in cities with previous treaty port histories were international chambers of commerce. For example, the American Chamber of Commerce in Shanghai was founded in 1915 and still exists and facilitates American investment into firms in Shanghai. These institutional apparatuses tend to endure because such institutions may beget new ones (Chen et al., 2013), creating increasing returns that reinforce local institutional advantage and may limit other locales'

opportunities to attract investment because of greater institutional distances and higher switching costs (Sydow et al., 2009).

Due to path dependency, contemporary foreign investors prefer to invest in locations with an atmosphere of contract enforcement, property rights protection, and international trade history. The legacy of these elements provides formal institutional arrangements to enhance investors' confidence. Foreign investors in various industries such as trading, banking, or manufacturing prefer those locations for investment (Jia, 2014; So, et al., 2011). For example, Yingkou, the first treaty port in northeast China opened to foreigners in 1861, has been favored by foreign investors and has recently seen a rise in FDI. Foreign investors also look for places with good corporate governance standards for their investment. For example, they regard cities such as Wenzhou (a former treaty port city) as a target location (The Bangkok Post, 2010).

Third, this formal legacy provides a rationale and references for contemporary institutional infrastructure building that meets local governments' interests and agendas. Thus, local governments have strategically used treaty port policies and their history as references to rationalize and design preferential policies for economic development zones (Keller et al., 2011; J.Wang, 2013) and to attract foreign investment to local companies. Historical referencing and new institution building help nurture a friendly environment for foreign investment (Du, Lu & Tao, 2008). For instance, Changchun, a treaty port opened primarily by Japan and Russia, established development zones that attracted many Japanese and Russian merchants (Harwit, 1996; Newswire, 2017). Since the 1980s, the municipal government in Tianjin, a previous treaty port city in northern China, aimed to reduce government intervention and create a Western market-oriented environment. In 1987, the Tianjin government set up a foreign investment service center, and by the end of 1996, the official estimate of cumulative FDI Tianjin received amounted to US$5.8 billion (Li & Zong, 2013).

In short, the treaty port policies were a rational design to facilitate international trade, and the government has used its legacy to attract inward FDI. One may argue historical treaty port cities would

receive greater inward FDI because these ports' physical infrastructures have endured. However, the improved infrastructure was the result of institutional arrangement and development. In fact, researchers found in the contemporary period, although some cities' local governments have improved physical infrastructure by cultivating ports and economic development zones, they still underperformed partially due to the lack of historical links and foreign recognition, thus losing the regional competition for attracting inward FDI (X. Wang, 2013; Xu, 2011).

Acemoglu, Johnson, and Robinson's (2001) study showed if actors make investments that are complementary to a particular set of institutions, they will be more willing to help these institutions persist. Treaty port policies and their legacy have the advantage of reduced formal institutional distance, legitimized foreign economic actors and businesses, and enhanced contemporary infrastructure building. These satisfy multiple actors' interests and thus can bring increasing returns to investment and create a path dependent trajectory. Therefore, this supports the following hypothesis:

> Hypothesis 1: Firms in cities that had treaty port policies exposure during the Treaty Port Era have a higher likelihood of receiving contemporary inward FDI, and the amount tends to be greater than those that did not.

Informal institutional legacy carried by overseas Chinese community

Actors form informal institutions to reduce transaction hazards and facilitate effective collaboration (North, 1990), and the cost of relying on informal rules to resolve problems is lower than relying on formal rules (Seyoum, 2011). Transnational communities create and maintain informal rules as they form and preserve shared and enduring social systems that are beneficial for meeting instrumental needs (Faist, 2000; Greve & Rao, 2012; Marquis & Battilana, 2009). These communities facilitate international trade through the mechanisms of enforcing social norms and conventions, prescribing codes of conduct, and securing trust and reputation. These informal institutional elements are crucial for reducing transaction costs and enhancing accountability and coordination (Greif, 1993; Li, et al., 2019; Seyoum, 2011).

Many overseas Chinese communities were formed during the Treaty Port Era when China

experienced its first major emigration boom of Chinese merchants and traders spreading throughout the world (McKeown, 1999). During that period, these actors pioneered import and export activities, developed business skills and social networks, and formed transnational communities in other countries with strong connections to their hometowns. This formation and the actors' persistence facilitated such informal institutional elements' creation, maintaining their enduring influence on international trade between China and the rest of the world.

In addition to providing preferential access for foreigners, the Treaty Port Era offered opportunities that Chinese businesspersons employed to form business associations and communities (Ma, 2008). These overseas Chinese communities used resources and cultural linkages to facilitate investment flows and bilateral trade (Liu, 2005; Tong, 2005). Since the Treaty Port Era, many cities, such as Jiangmen in Guangdong, Wuhan in Hubei province, Harbin in Heilongjiang province, and Fuzhou, Zhangzhou, and Quanzhou in Fujian province, have become well-known hometowns (*qiaoxiang*) of overseas Chinese businesspeople.

Although both treaty ports and overseas Chinese communities emerged and developed during the Treaty Port Era, the two entities differed in their geographic distribution. While there are some overlaps in their geographic distributions, the differences between treaty ports and ancestral homes are also salient: many overseas Chinese communities emerged and developed from locations that were not treaty port cities (Fei, 1946) for the several reasons. First, because treaty ports provided additional local economic opportunities and trade advantages, merchants were able to use these benefits and their relationships with foreigners to accumulate wealth locally (Hao, 1970). This was reinforced by Chinese traditional culture's emphasis on emotional attachment to hometown and filial piety; thus, merchants did not necessarily migrate abroad to explore business opportunities (Chung, 1999). In contrast, many merchants from inland cities (i.e., not treaty ports) started migrating overseas to explore wider business opportunities and alleviate poverty. In particular, merchants from regions where the economy and transportation were underdeveloped interacted with each other more frequently and cultivated strong collaborative

community cultures (Liu, 2005).

Today, over 30 million ethnic Chinese live outside mainland China (Liu, 2005), and many have invested significantly in their ancestral hometowns in terms of financial capital, advanced technology, and human capital, thereby facilitating international capital inflows to China (Gao, 2003; Qiu, 2005). Since China reopened its doors to the outside world in 1978, these overseas Chinese people have provided more than two-thirds of the foreign investment in China (Buckley, Clegg, Cross, Liu, Voss & Zheng, 2007; Du et al., 2008). This seems to indicate informal institutions have been developed and carried on by Chinese traders, merchants, and the intermediary class within the overseas Chinese communities to guide interactions and transactions through the mechanisms of prescribing codes of conduct and enforcing *guanxi* practice to secure trust and reciprocity.

The first mechanism by which informal institutions create an enduring influence on contemporary FDI is through the codes of conduct prescribed and deposited for business transactions by traders, merchants, and the intermediary class within the overseas Chinese community over time. Landa (1981, 1994) found traders and merchants formed codes of business conduct by drawing on Confucian ethics that differentiate between close and distant bonds and insiders and outsiders and which led to developing different expectations for business partners' behaviors. Trading partners who were linked by kinship or ethnic ties were expected to comply with prescribed codes of business conduct because economic sanctions would be imposed upon the trading partner who violated the codes. The sanctions included "withdrawal of credit so that [the] offending party has to deal on a cash basis," "expulsion from the group via bankruptcy proceeding," and "exclusion from future transactions" (Landa, 2016: 179).

Business codes of conduct were further channeled and reinforced by overseas Chinese business associations (Gao, 2003; Tong, 2005), which delineated moral standards and trading norms. Guided by these informal rules, overseas Chinese hometown associations and local Chinese chambers of commerce (*shanghui*) shared market information, deterred opportunistic behavior, and matched buyers and sellers inside and outside China (Chung, 1999). According to Liu, "through formulating and sustaining proper

codes of behavior and supporting Chinese cultural values, Chinese social organizations have played a part in fostering a sociocultural ethic" (2000: 112) that was conducive to business transactions. He estimated that from the 1960s to the 1990s, about 100 world conventions of overseas Chinese associations had been held.

The second mechanism by which informal institutions persistently influence contemporary FD is through the enforcement of *guanxi* practice. *Guanxi* is defined as a particularistic personal connection between individuals who are bound by an implicit psychological contract to follow social norms, such as maintaining a long-term relationship, loyalty, and obligation (Chen & Chen, 2004). *Guanxi* plays a role as an informal institution in bonding traders and merchants through *xinyong* and *renqing* (Li, 2007; Wang, 2000). *Xinyong* refers to the trustworthiness of the other party, and *renqing* emphasizes the sense of obligation owed to each other (Chen & Chen, 2004). Chinese merchants and traders formed and enforced such informal rules to share information, facilitate mutual aid, help garner critical resources, and deal with business challenges inherent in an early period of cross-border trade (Smart, 1999). Landa (2016: 201)found that as rational economic actors, a Chinese trader will "enter into exchange relations with those whom he can trust, who are usually members of family, clan, fellow villagers and members of his own ethnic group" (2016: 201). These normative rationales and business routines have been translated into stories and toolkits that are passed between generations (Greve & Rao, 2012; Swidler, 1986) and become critical references and resources for continuous transactions (Quattrone, 2015).

Nowadays, overseas Chinese communities continue to reproduce and use *guanxi* to facilitate international investment and trade. With a mixture of sentimental and instrumental elements (Kuah, 1999), merchants and traders actively promote transactions between overseas Chinese and their ancestral hometowns. Because of their familiarity with the norms and practices of *xinyong*, *renqingi*, and other fundamentals of *guanxi* building, they can invoke these ties to initiate business based on cultural familiarity and ethnic affinity. Cities with an overseas Chinese community have another advantage for attracting FDI: a faster decision-making procedure facilitated by *guanxi* and an ethnic link. Most ethnic

Chinese companies are family owned, and although some of them are listed as public companies, they remain under the control of founding families. When the top management team spots an opportunity, they can decide to quickly invest, despite the project at first seeming very risky (Wang, 2000). In addition, overseas Chinese have also facilitated FDI from other foreign companies, which often use Chinese employees to ease negotiations and operations because without overseas Chinese assistance, foreign companies would face difficulty investing and operating in China (Wang, 2000).

Research has shown that many cities in Guangdong and Fujian provinces received investments from Chinese Singaporeans whose ancestors originated from there (Tong, 2005), and Chinese Americans established most U.S. multinational corporations in China (Du et al., 2008). Meanwhile, government officials in the overseas Chinese hometowns have worked to identify foreign capitalists whose ancestors lived in their jurisdictions; they recognize a strong attachment to the locality helps legitimate investors' business activities in the eyes of local citizens and could also persuade investors to funnel more money into their ancestral hometowns. Although overseas Chinese are called members of the Chinese diaspora, they have a close affinity with China and share norms of reciprocity and obligation, despite their living in different parts of the world (Chan & Ng, 2000; Dahles, 2010). Lack of this type of overseas community could explain the sharp contrast between China and Russia. Although Russia has tremendous resources and human capital and the government has actively encouraged foreign investment, it still has a poor record attracting FDI (Wang, 2000).

In short, merchants, traders, and commercial associations within Chinese transnational ethnic communities gradually formed codes of business conduct and enforced *guanxi* practice. These informal institutional elements have been deposited, institutionalized, and reproduced to guide business transactions through generations, leading to a path dependent approach to FDI flows between China and the rest of the world. It appears the overseas Chinese community facilitates the institutionalization and reproduction of informal institutions because the economic actors within the community embody "customs, traditions, and codes of conduct" (North, 1990: 6) that have been carried on through

generations. Thus, firms located in the ancestral hometowns of overseas Chinese communities of the Treaty Port Era are more likely to receive contemporary inward FDI. This leads to proposing Hypothesis 2:

> Hypothesis 2: Firms in cities that had an overseas Chinese community during the Treaty Port Era have a higher likelihood of receiving contemporary inward FDI, and the amount tends to be greater than those that did not.

The mediating role of the informal institutional legacy

Informal institutions often shape, elaborate upon, and extend formal rules (North, 1990). As a carrier of informal institutions, overseas Chinese communities may mediate the positive relationship between formal institutional legacy and contemporary inward FDI. First, treaty port policies facilitated the formation of the overseas Chinese communities, which created and maintained informal institutional elements such as codes of business conduct and *guanxi* practice, as elaborated earlier. Formal rules can constitute social life and help individuals and organizations legitimize normative demands (Suchman & Edelman, 1996). The primitive and constitutive legal environment enforced by treaty port policies shaped community norms and business conduct and ethics in relation to agency, responsibility, and accountability (Lempert & Sanders, 1989). It also aligned with the interests of Chinese merchants and traders by encouraging mindsets of economic rationality and efficiency in the local business community and providing a new logic that "seep[s] into [the] culture and infrastructure of social interaction" (Edelman & Stryker, 2005: 541). In addition, Western merchants experienced transaction difficulties because of language barriers and the complexities of commercial practices and social customs (Hao, 1970), and this opened an opportunity for the middleman class, mercantile groups, and intermediary organizations to emerge from the community and act as intermediaries to bridge the gaps. Compradors, for example, emerged and acted as agents to intermediate foreign and domestic business. Jernigan described the role of the comprador as "not only to bring buyer and seller together, to settle all disputes, to find necessary funds, to secure his employer against loss . . . but [also] to supply and be responsible for the whole of the

business and domestic ménage" (1904: 386). Because compradors and Chinese merchants attracted the loyalty of the native staff, who were often relatives and neighbors within their own community, foreign enterprises relied heavily on them to collect and distribute goods (Rawski, 1969).

Second, once they emerged, the overseas Chinese communities were likely to selectively translate the formal rules of treaty port policies, internalize them into practice, and facilitate their diffusion. When formal institutions are imported and enforced across borders, they often need to be translated by local actors to fit into national and local contexts (Jackson & Deeg, 2008; Kostova, 1999). Formal rules such as treaty agreements and trade policies are created in written format through official channels; they may be complex, less visible, hard to codify, and not routinely enforced (Helmke & Levitsky, 2004), and thus they are at risk of being incompatible with the local society at large. When (formal) treaty port policies were enforced during the colonial period, they were met with local confusion and resistance (Hamashita, 2003). In contrast, informal rules, created and communicated within communities, can facilitate collective understanding, learning, and assimilation of formal rules (Helmke & Levitsky, 2004).

The previously mentioned comprador-merchants had certain authority in interpreting the treaty policies and trade rules and translating them into informal rules and practices that could be understood and implemented by other businesspeople (Hao, 1970). They surveilled the conduct of the businesspersons and reported misgivings to the authorities. One important activity they engaged in was to guarantee the solvency of the Chinese banks and businessmen with which the comprador's firm dealt. The comprador's organization was referred to as a "Chinese firm within a foreign firm" (Kwan, 1991: 64), and their comparatively high social status also promoted their social influence and practice diffusion in the fields of commerce and foreign affairs (Hao, 1970).

Landa (1981: 352)found that under the environment where the legal framework is not well developed, ethnically homogeneous middleman groups equipped themselves with a "calculus of relation" (1981: 352) and formed informal rules to secure trust and transaction. Thus, because of their mutual business interests and coordination efforts, merchants and the middleman class within overseas Chinese

communities helped translate, legitimize, and diffuse formal trade rules, which generated increasing returns on their investment. The synergy resulting from the interaction between formal and informal institutions consolidates the effects proposed in Hypotheses 1 and 2.

Third, during constant institutional upheavals, the formal rules prescribed by treaty port policies morphed and evolved into informal rules that have been maintained by the overseas Chinese community and continuously affected inward FDI. Since the Treaty Port Era, China has experienced both the Republican Revolution and the Communist Revolution, during which the traumatic shock of the Cultural Revolution was deliberately enforced to eliminate foreign influence. Because formal rules are politically contested, they need to be "mediated by day-to-day organizational life" (Suchman & Edelman, 1996: 941) and may become obsolete over time. Although political events and shocks have eliminated treaty port policies and weakened their direct influence, the concepts and terms of rationality, accountability, and efficiency prescribed by the policies have evolved and been transformed into informal rules that are more resistant to change. The middleman class and intermediary organizations acted as "filtering agents" (Suchman & Edelman, 1996: 933) and developed their strategy and capacity to transform the meaning of the formal rules into norms, values, and practices that suited community interests and ideologies. According to Landa (1981, 1991), under legal inefficiency and contract uncertainty, codes of conduct emerged in the Chinese ethnic middleman group, thus internalizing externalities. This group now functions as a cultural transmission unit, enabling younger generations to inherit community norms, business conducts, and *guanxi* practice from their ancestors and creating ethnic boundaries that persist over time for outsiders. In short, the evolution of the overseas Chinese community has created reinforcing mechanisms by positively contributing to inward FDI, leading to strengthening the path dependent investment trajectory. This is reflected in Hypothesis 3:

> Hypothesis 3: The overseas Chinese community (the carrier of informal institutions) mediates the positive effect of treaty port policy legacy on contemporary inward FDI.

The moderating role of the Cultural Revolution as a traumatic shock

Although formal and informal institutions initiate institutional advantages and create path dependent trajectories in determining inward FDI, traumatic shock can disrupt these paths and reshape the institutional environment for modern firms (Sydow et al., 2009). Klüppel et al. suggested that traumatic shocks are featured by the "direct and immediate magnitude of the impact" such as "loss of life, psychological trauma, economic or infrastructure destruction" (2018: 707), and their duration is long enough to persistently change the existing formal and informal institutions. Political traumatic shock presents an overwhelming disruption, translocating existing institutions onto new paths and dramatically affecting the business environment and firms' activities (Ashforth & Saks, 1996; Klüppel et al., 2018). Siegel et al. (2011, 2013) found that the Communist Revolution influenced foreign firms' entries and international alliances. Later, Kozhikode (2016) proposed a theory of organizational dormancy, arguing that firms can become strategically inactive in response to detrimental public policies until more favorable policies return.

In modern Chinese history, the Cultural Revolution (1966 to 1976) represents a traumatic shock that featured a decade of political and ideological warfare that emphasized class struggle and condemnation of the West (Esherick, Pickowicz & Walder, 2006; Lu, 2004; Zhou & Hou, 1999). This occurred when Mao and his government intentionally demarcated a period through sharp contrast with the past and actively dislodged institutional legacies captured by Western influence (Marquis & Qiao, 2018). The mass rallies that characterized the period targeted anything and anybody related to capitalism (i.e., the West). The Cultural Revolution focused specifically on the elimination of the formal Western institutional infrastructure and caused massive political and economic turmoil, which destroyed written rules conducive to business and social exchange and created confusion and uncertainty concerning business transactions (Jia, 2014).

Specifically, the movement aimed to "bury capitalism," "throw out anything related to capitalism and fully embrace socialism," and "promote [the idea] that socialism is the most superior institution whereas capitalism is the root of all evil" (Lu, 2004). These political and ideological slogans and the associated

propaganda were crystalized as social rules that guided action during this decade when China was sealed off from the outside world. Deng Xiaoping, the de facto supreme leader who succeeded Mao, recalled that during the Cultural Revolution, activists prohibited the country from learning about advanced technology and knowledge from the West, labeling it "a slavish comprador philosophy" that "worships foreign things and xenophilia," (Deng, 1984) and proclaiming that having any connection to the West was tantamount to treason.

This deliberate traumatic shock abolished the climate of cooperation and mutual trust established in the Treaty Port Era, destroyed human and social capital, and hindered the reproduction of existing Western institutions in China. Thus, it increased institutional distance by destroying formal institutional links with foreign businesses in China and negating their legitimacy. By emphasizing hostility to foreignness, it undermined the legitimacy of foreign capital, which hindered subsequent investment.

Traumatic shock differentially affects populations or regions (Klüppel et al., 2018); therefore, the Cultural Revolution also tended to create local variations in how formal institutional legacy influences contemporary inward FDI. Industrial research based on surveys and interviews showed political uncertainty at both the national and regional level in China is still a major concern for foreign investors' (Graham & Wada, 2001; Renwald, 2005; Wu, 1982). Bremmer and Zakaria (2006) pointed out that in China, compared to local investors, foreign investors are more vulnerable to an uncertain and politically influenced investment climate. Perceiving the negative impacts, foreign investors are more cautious and selective in their local investment choices. Therefore, it might be assumed the legacy effects of the treaty port policies are likely to be reduced in those cities most affected by the Cultural Revolution, which thus lowers FDI inflows to local firms. From this, Hypothesis 4a is proposed:

> Hypothesis 4a: The positive effect of the Treaty Port Policies on contemporary inward FDI is likely to be reduced for firms located in cities where the impact of the Cultural Revolution was greatest.

Furthermore, the Cultural Revolution damaged the historical link between the overseas Chinese community and foreign business activities. During this traumatic shock, companies in China owned by

overseas Chinese investors were prohibited from remitting funds to these investors. The Chinese government even suspected that Chinese people living overseas worked as spies for capitalist governments (Godley, 1989), and some were arrested and their property confiscated (Gold, 1990). Overseas Chinese originating from cities that suffered more during the Cultural Revolution often had to abandon their investment activities in mainland China (Maddison, 2007).

However, following this traumatic shock, cities that suffered the most severe impacts of the Cultural Revolution may also have been the beneficiaries of compensation from the overseas Chinese community because of the restoration of historical links. Informal institutions such as norms, customs, and traditions represent high levels of an institution, and their deep embeddedness in society and community causes them to change slowly and makes them resistant to external disruption (Williamson, 2000). A transnational ethnic community is a powerful source of social similarity, obligation, and continuous solidarity (Greif, 1993; Li et al., 2019). Long-standing identity and tradition associated with locations facilitate adoption of similar practices to those of ancestors (Marquis & Battilana, 2009) and thus may help restore disrupted relations and investment practices.

In cities where the Cultural Revolution was most intense, young overseas Chinese were likely to restore interrupted historic cultural or familial links. For example, Kuah (1999) found that overseas Chinese were keen to find their roots (*gen*) and seek ancestors with which to form "moral-cultural" capital, whether they were financially successful or not. Social identification based on locality and attachment to ancestral hometowns is prevalent in China, even in the election of members to the Chinese Academy of Sciences (Fisman, Shi, Wang & Xu, 2018). Since the 1980s, this has led to a global revival of *qiaoxiang* ties. Investments in their hometowns by overseas Chinese grew dramatically. The diaspora-dominated inflow of investment increased from 3.6% of China's capital investment in 1985 to 8% in 1994. Foreign-affiliated ventures produced nearly 20% of the total industrial output and nearly 30% of total exports in 1994. China's changing institutional environment and the abundant business opportunities that emerged during the reform provided incentives for overseas Chinese to renew and reaffirm their ties with

their ancestral hometowns (Hong, 1999).

In addition, local governments have also contributed to the revival of *qiaoxiang* ties between overseas Chinese and their ancestral hometowns. Some local governments have acknowledged the Cultural Revolution experience has damaged the sense of ethnic community and impeded inward FDI. Thus, during China's opening-up period, local governments worked to mitigate the negative impacts and provided incentives to attract overseas Chinese to invest in their ancestral hometowns, helping them regain the confidence and trust to do business therein. For example, the Xinhui district is a famous *qiaoxiang* in the city of Jiang Men, Guangdong province. Since the late 1970s, the Xinhui government and its township governments sent delegations overseas every year to attend overseas clansmen's anniversaries and inauguration ceremonies. Leaders of overseas clansmen's associations and trade associations have gradually established good relationships with the Xinhui government and often organized delegations to visit their hometowns and explore investment opportunities. As a result, from 1979 to 1993, overseas Xinhui communities made donations with a value of over HK$800 million, and they also invested in 580 enterprises, involving a sum of about US$760 million (Hong, 1999). In short, the damaging effects of the Cultural Revolution on overseas Chinese investment activities during that period must be acknowledged; however, the intense Cultural Revolution experience may have caused the overseas Chinese community to make investments to compensate for the links broken as a consequence. This impression leads to positing Hypothesis 4b.

> Hypothesis 4b: The positive effect of the overseas Chinese community on contemporary inward FDI is likely to be enhanced for firms located in cities where the impact of the Cultural Revolution was greatest.

METHODS

Sample

This study explores (a) how formal and informal institutional legacies have helped cities develop institutional advantages that may increase both the likelihood of local firms receiving contemporary

inward FDI and the amount received and (b) how traumatic shock might affect these effects. The data and analysis are drawn from a research project the author participated in. The other researchers and the author obtained a sample of Chinese manufacturing firms with total assets of over five million RMB (around 600,000 U.S. dollars in 2003) for the period between 1998 and 2013 from the Annual Industrial Survey, which provides the most comprehensive set of data on large manufacturing firms in China (Zhang et al., 2010). Information on treaty port policies was coded from the Chinese Maritime Customs database (Catchpole, 1976: 22; Ebrey, 1993: 311; Huang, 1990: 204-206; Hutchings, 2003: 131-132, 417, 436-439; Waley-Cohen, 2000: 148-150). In the data, overseas Chinese refers to all Chinese living outside mainland China and Taiwan, including *huaqiao* (Chinese citizens residing abroad), *huaren* (naturalized citizens of Chinese descent), and *huayi* (descendants of Chinese parents). To qualify these labels, cities or regions should have a certain amount of overseas Chinese residing within the local population. Information on overseas Chinese communities was collected from Pan (1999), Zhou (2001), official websites, and reports of local governments to identify whether cities have these various types of overseas Chinese people. These data sources provide information on whether a particular city or region is a *qiaoxiang*, the communities where many overseas Chinese originated and in which their family members might still reside. Population-related data used to test the Cultural Revolution effect were collected from the 1964 and 1982 Population Censuses of China. City-level control variables were coded from China Regional Yearbooks, China City Statistical Yearbooks, statistics from the Civil Aviation Administration of China, and various historical and online resources that document historical events that might have a bearing on international business activities. Eventually, we obtained a firm-year longitudinal sample with 26,890 manufacturing firms (206,187 observations).

Key variables

The dependent variable *inward FDI* was measured on an annual basis according to: (1) whether the firm received foreign investment (Dees, 1998) in the focal year (its value is 0 for a firm that did not receive FDI); and (2) the logarithm of the total amount of foreign investment received by the firm

(Strange, Filatotchev, Lien & Piesse, 2009).

We used a binary variable to indicate a formal institutional legacy: a city with former treaty port policies took a value of 1 if the city in which a firm is located was a treaty port during the Treaty Port Era; otherwise, it was 0. We indicated informal institutional legacy similarly: a firm with its headquarters in a city with an overseas Chinese community was assigned a value of 1 if the city is a known hometown (*qiaoxiang*) of overseas Chinese; otherwise, it was 0 (Pan, 1999). Like other studies examining the effects of historical events on firm behaviors and performance, the two institutional legacy measures are time invariant (Marquis & Qiao, 2018).

During the Cultural Revolution, all governmental record keeping was disrupted for that period; therefore, we used the change in population between the last census before the Cultural Revolution (1964) and the first census after it (1982) to capture the moderating effect of the Cultural Revolution. The extent to which a city's population was reduced during this period was taken as an indicator of the local severity of the Cultural Revolution. We reverse coded the variable, subtracting the current value of the variable from its maximal value of all observations. School attendance was not encouraged during the Cultural Revolution, but participation in the Communist Revolution, including the sabotage of educational facilities, was (Zhou & Hou, 1999). Thus, to indicate the impact of the Cultural Revolution, we reverse coded data on the increase in the illiteracy rate at the provincial level from 1964 to 1982. This illiteracy data yielded similar results to the analysis of cities' population changes.

Control variables

We first controlled for several firm-level characteristics that might affect foreign investment and that vary from year to year (Du et al., 2008; Zhang et al., 2010). These included (1) *firm size*, measured by the logarithm of total assets because larger firms tend to attract FDI based on their transparency and capacity; (2) *financial leverage* (debt-to-asset ratio), which might indicate a firm's financial health and organizational slack and be of concern to foreign investors; (3) *asset tangibility* (tangible assets over total assets), which may help reduce information asymmetry and thus attract FDI; and (4) *firm age*, which

captures a firm's existence duration and indicates its maturity and visibility and thus its ability to capture foreign investors' attention (Zhang, Marquis, & Qiao, 2016).

We then controlled for time-varying industry characteristics to exclude explanations from the perspective of current industry factors. Specifically, we controlled for *industry-level inward FDI*, the basis upon which foreign investors might decide to invest in focal firms (Marquis & Qiao, 2018), and we computed the average value excluding that of the focal firm. We also controlled for *industry-level innovation*, which might attract foreign investors seeking strategic assets (Dunning & Lundan, 2008).

To rule out confounding factors in the contemporary picture, our analysis also included a set of contemporary city-level variables to control for market attractiveness and environmental characteristics on a yearly basis. We first controlled for economics-related variables. Logarithms of *GDP* and *population* are measures of market size and potential (Strange et al., 2009) because they affect infrastructure, productivity, and purchasing power, which in turn influence FDI inflows (Marquis & Qiao, 2018) and are widely used to gauge city sizes in the FDI literature (Du et al., 2008). Because we were considering the sizes of investments, we controlled for *inflation rate*, as gauged by the Consumer Price Index. *Labor cost* is another indicator of a locality's economic situation that affects foreign investment inflows (Wei, Liu, Parker & Vaidya, 1999); this was measured by the logarithm of average wage. The level of global integration and mobility of global capital may drive foreign capital to invest in China, and at the city level, we used the value of trade (i.e., the sum of imports and exports relative to GDP) as a proxy for the *openness of the economy* (Bhalla, Yao & Zhang, 2003).

We then considered a set of infrastructure-related factors that also vary on a yearly basis. First, we controlled for whether a city had an *urban center* (1 = yes) because a concentration of firms in more urbanized locations can better attract FDI. Transportation conditions are another determinant of inward FDI (Wei et al., 1999), so our analysis included the logarithm of *length of roads* as a measure of this. We further controlled for *airport presence* because air travel tends to faciliate business activities (Marquis, 2003), especially international transactions.

Moreover, China's regional economic geography varies considerably from east to west: coastal cities in the east have more advantages in creating economic development zones and attracting FDI than the inland cities of the west (Bhalla et al., 2003). In addition, different regions have differing histories in terms of international business activities. These are time-invariant variables that help alleviate the confounding influence of unobservable heterogeneities. Specifically, we controlled for whether a city is located in a coastal area, *coastal city* (1 = yes) because coastal cities are more likely to attract FDI due to their geographical location. Second, a canal-based location facilitates inland transportation, and we controlled for *canal city* (1 = yes). Lastly, all variables on the right-hand side of the models were lagged by one period to avoid reverse causation. Table 1 lists all variables employed, their definitions, data sources, and computations.

---- Insert Table 1 about here ----

Estimation method

We selected our estimation approach based on two important characteristics of the research setting and model. First, the establishment of treaty port policies and/or the development of an overseas Chinese community in certain cities might be endogenous to some political and geographical factors, which may also affect contemporary inward FDI. For example, cities in certain geographical locations that have had exposure to the international business environment, such as coastal cities, may have some unique advantages for attracting contemporary FDI. We used propensity score matching (PSM) (Rosenbaum & Rubin, 1983) to correct for this potential non-random treatment effect by matching treatment cities (i.e., those with either treaty port policies or an overseas Chinese community or both) with the control group (i.e., cities with neither of these institutional legacies) according to certain characteristics that might affect whether a city was chosen as a treaty port and/or became the hometown of an overseas Chinese community. After matching, the treatment group and control group should be similar in terms of these characteristics. Thus, in the first step, we predicted the genesis of institutions for each city (i.e., a city's respective likelihood of becoming a treaty port and/or a hometown of overseas Chinese) using the whole

set of control variables with a random-effects multinomial logistic model. Fixed-effects estimation is not applicable because of the incidental parameter problem: there are too many parameters to be estimated, and, therefore, models for limited dependent variables (e.g., multinomial logistic, probit and Poisson) will not deliver consistent results (Lancaster, 2000). In addition, fixed-effects estimation will drop key variables because they are time invariant.

In the second step, we generated the propensity scores, which are the predicted chances of becoming a treaty port and a hometown of overseas Chinese. We used the propensity score to match the treatment group with the control group, using a nearest-neighbor algorithm without replacement and a set caliper (0.25 standard deviation) (Zhang et al., 2016). We also ensured the matching quality and performed related checks, including (1) shrinking the explanatory power of variables in predicting treatment (i.e., having either institutional legacy) to less than 0.1%; (2) diminishing differences of covariates at the 5% level between the two groups after matching; and (3) ensuring the percentage biases of all variables dropped below the 5% level. We therefore showed after matching, the institutional legacies can be regarded as exogenous to the extent that we have ruled out selection on observable variables.

The second important aspect of our chosen estimation approach, the sample-induced selection issue, is another potential concern because not all firms have inward FDI. Therefore, we applied a Heckman model (Heckman, 1979) and followed the recommendations of Certo, Busenbark, Woo, and Semadeni (2016) and Lennox, Francis, and Wang (2012) in performing our analysis. Specifically, for the matched sample, we first ran a random-effects probit model and predicted the inverse Mills ratio. Based on recent recommendations (Certo et al., 2016; Lennox et al., 2012), we controlled additional variables (i.e., the exclusion restrictions) that predict in the first stage the likelihood of receiving FDI, but not in the second stage the amount of inward FDI. Therefore, the Heckman results are more robust and less sensitive to multicollinearity (Wolfolds & Siegel, 2019). The exclusion restrictions included R&D intensity (scaled by total sales), profitability (by return on assets), industry competitiveness, and industry sales growth (Marquis & Qiao, 2018). According to existing studies, these variables might predict the likelihood of

inward FDI, but the effects are controversial (Villalonga & McGahan, 2005) and thus unlikely to predict the amount of FDI (Marquis & Qiao, 2018). We included them in the second-stage regressions and found they did not affect the amount of FDI. Taken together, these exclusion restrictions are valid. Then, based on samples with firms having inward FDI, we employed a random-effects linear model and also controlled for the inverse Mills ratio. Based on scholars' recommendations (Certo et al., 2016; Lennox et al., 2012), we also considered other sources of endogeneity (Meyer, van Witteloostuijn & Beugelsdijk, 2017) by adopting propensity score matching analysis, as already outlined. These analyses suggest that our results are robust. In addition, we collected an alternative dataset from the China Stock Market & Accounting Research (CSMAR) and re-ran the analysis, the results are consistent with those reported in the main analysis.

RESULTS

Descriptive statistics and correlations of the data for the two samples are reported in Table 2. All correlation coefficients between variables on the right-hand side of the model are smaller than the rule-of-thumb value of 0.7. Meanwhile, all variance-inflation factors in the regressions were below the rule-of-thumb cutoff of 10 (Cohen, Cohen, West & Aiken, 1983). Therefore, multicollinearity did not pose a concern for analysis.

---- Insert Table 2 about here ----

Table 3 presents the results of the propensity-matching checks. The first three columns exhibit the multinomial logistic regression results, showing the control variables and exclusion restrictions predict the likelihood of treatment (i.e., having institutional legacies). Columns 4 and 5 show differences of variables in the treatment and control groups (with and without institutional legacies, respectively) become similar after matching, and the post-matching percentage bias was reduced to less than 5%, which is the acceptable threshold (Zhang et al., 2016). Finally, the mean percentage bias declines to 1.5%, and the pseudo-R-squared for predicting treatment with these variables drops substantially. Taken together, these results suggest treatment can be regarded as random to the extent that we have ruled out the

selection on observable variables. The final sample contained 162,067 firm-year observations.

---- Insert Tables 3 and 4 about here ----

In Table 4, columns 1 and 8 are the baseline models for the likelihood and amount of inward FDI, respectively; columns 2 and 3, and 9 and 10 test Hypotheses 1 and 2, respectively, for the same two things. Column 4 tests Hypothesis 3, while columns 5 and 6, and 11 and 12 test Hypotheses 4a and 4b, the moderating effect of the Cultural Revolution on the likelihood and the amount of inward FDI, respectively. Columns 7 and 13 represent the full models for the likelihood and amount of inward FDI, respectively.

Hypothesis 1 proposes firms in cities with a formal institutional legacy (i.e., historical treaty port policies) are more likely to receive FDI. Columns 2 and 9 in Table 4 show being located in such cities makes them 31% more likely to receive FDI (β = 1.064, p = 0.000), and for those that do receive FDI, they obtain more than five times (463.2%) the FDI of firms in cities without former treaty port policies (β = 4.632, p = 0.000; $6,561). Again, the effects are considerable. Hypothesis 1 is thus supported.

Hypothesis 2 posits that firms in cities with a historically generated overseas Chinese community are more likely to receive FDI. Columns 3 and 10 in Table 4 show being located in such cities makes them 68.2% more likely to receive FDI (β = 2.150, p = 0.000), and for those that do receive it, they obtain nearly four times (400%) more FDI than firms without such a legacy (β = 4.000, p = 0.000; $5,666.66). The effects are economically sizeable as well. Hence, Hypothesis 2 is supported.

Hypothesis 3 proposes an overseas Chinese community mediates the positive effect of treaty port policies on contemporary inward FDI. We used three ways to test the mediation (Aguinis, Edwards & Bradley, 2017; MacKinnon, Lockwood, Hoffman, West & Sheets, 2002). First, column 4 in Table 4 shows cities with treaty ports are 11.6% more likely (β = 0.242, p = 0.000) to develop an overseas Chinese community than cities without treaty ports. Meanwhile, columns 3 and 10 in Table 4 show after controlling for the mediator (the overseas Chinese community), a treaty port legacy's effect on contemporary inward FDI shrinks, but an overseas Chinese community still affects FDI (p = 0.000 for both likelihood and amount). Based on coefficient differentials (Aguinis et al., 2017), the mediation

hypothesis is supported. Second, combining the results from columns 2, 3, and 4 with columns 9 and 10 in Table 4, we find a treaty port legacy affects (1) inward FDI and (2) overseas Chinese communities, which (3) predicts inward FDI with the presence of a treaty port legacy. Therefore, causal step analysis also supports the hypothesized mediation. Third, we employed a product coefficient test as recommended by MacKinnon et al. (2002) and still obtained supporting evidence for the mediation effect. Therefore, Hypothesis 3 is supported.

Hypotheses 4a and 4b predict the influence of the Cultural Revolution reverses the positive effects of treaty port policies but strengthens the effect of an overseas Chinese community on inward FDI. In table 4, column 5 shows the interaction between the Cultural Revolution and treaty port policies is negative (β = -0.635, p = 0.000) for the likelihood of inward FDI; column 11 shows this interaction is negative (β = -0.285, p = 0.000) for the amount of inward FDI. In Table 4, column 6 shows the interaction between the Cultural Revolution and an overseas Chinese community is positive (β = 0.451, p = 0.000) for the likelihood of inward FDI; however, column 12 shows this interaction is partially positive (β = 0.216, p = 0.000) for the amount of inward FDI. Therefore, Hypothesis 4 is partially supported, especially for the likelihood of its occurrence.

We performed a wide range of robustness checks on the proposed theoretical model. First, if the proposed theory holds, more inward FDI in former treaty ports should come from the foreign countries that opened them, and more inward FDI in the ancestral hometowns of overseas Chinese communities should come from the countries to which they emigrated and where their descendants now reside. To perform the analysis with more nuanced dependent and independent variables, we first traced the country of origins of inward FDI using data about the largest investors/shareholders because the entire investors' profiles were not available. The data recorded the top three largest owners, and we aggregated their shares to obtain the amount of inward FDI by country. In terms of a treaty port legacy, we manually traced which country opened the treaty port and then generated a set of six dummies to indicate those of the United States, Russia, Germany, Japan, France, and the UK. Similarly, we hand-coded the six major countries of

residence of the overseas Chinese communities. We employed the second step of the Heckman model, random-effects linear models, with a seemingly unrelated regression approach to compare coefficient estimates (Zellner, 1962), controlling for the corresponding variables for amount of inward FDI. Table 5 shows firms in former treaty ports received the most contemporary FDI inflows from the country or countries that opened the port. Paired *t*-tests and a Wald test support this observation; for instance, on average, firms in treaty ports opened by the UK, including Ningbo, Xiamen and Shantou, received more FDI from the UK than from other countries. Similarly, those opened by Japan, such as Changsha, Jingzhou, and Yichang, received more FDI from Japan than from other countries. Table 5 also shows firms in the hometowns of overseas Chinese communities received the most contemporary FDI inflows from the countries in which their overseas Chinese offspring currently reside; again, paired *t*-tests and a Wald test support this observation. For example, Quanzhou, Zhangzhou, Jiujiang and Chaozhou are ancestral hometowns of Singaporean Chinese and received more FDI from Singapore than from other countries; Jiangmen, a hometown of Chinese Americans, received more FDI from the United States than from any other country.

---- Insert Table 5 about here ---

In addition, we employed alternative measures for the key constructs. For example, one alternative measure is whether a city had foreign concessions in its history; this was a derivative institution of treaty port policies (Marquis & Qiao, 2018). The Chinese government granted concessions to foreign powers in certain places that became foreign countries' enclaves in China, and the foreign governments implemented their own legal systems to govern these concessions. We used information whether a city had foreign concessions as an alternative proxy of the formal treaty-port-induced institutional legacy to test our hypotheses and obtained similar results. Meanwhile, we employed the change of illiteracy rate from 1964 to 1982 to measure the intensity of the Cultural Revolution at the provincial level (X.G. Zhou & Hou, 1999), and we obtained similar results to those previously reported. Finally, results from the non-matched full sample are consistent with what has been reported.

DISCUSSION AND CONCLUSION

This study sought to identify the role of historical informal institutions in affecting contemporary international business activities. How formal and informal institutional legacies created by treaty port policies and carried out by overseas Chinese communities shaped cities' institutional environments and created path dependent advantages that affected local firms' propensities to receive more contemporary inward FDI was examined by drawing on rational choice institutionalism and integrating it with the path dependence perspective. The results show firms located in cities with greater exposure to treaty port policies and overseas Chinese communities developed during the Treaty Port Era are more likely to receive FDI and at greater volumes than firms in cities without such legacies. In addition, through translating and internalizing formal rules into informal rules, the informal institutional legacy carried out by overseas Chinese communities mediates the positive relationship between treaty port policies and inward FDI. However, the results suggest these effects are altered by a political traumatic shock: firms located in former treaty port cities receive less inward FDI in terms of both likelihood and amount if they are located in cities more severely affected by the Cultural Revolution. Interestingly, firms are more likely to receive inward FDI if they are located in cities with overseas Chinese communities that were more severely affected by the Cultural Revolution. This is probably because of the compensatory efforts made by overseas Chinese to restore broken historical links in the new period. However, to a certain extent, these investments appear symbolic: overseas Chinese investors do not invest substantial amounts in these places due to potential investment risks.

Contributions

By integrating rational choice institutionalism with the path dependence perspective, this study first shows, despite more than 150 years after their creation, how institutional legacies, particularly an informal one, play crucial roles in sustaining international business activities. Prior research has mainly adopted rational choice institutionalism to explain the creation and functions of formal institutions (Hall & Taylor, 1996; Shepsle, 2006). This research extends this perspective by exploring how historical

informal institutions continuously affect contemporary inward FDI, and it argues merchants, trades, and intermediary class within overseas Chinese communities gradually formed codes of business conduct and enforced *guanxi* practice. These informal institutional elements have been deposited, institutionalized, and reproduced to guide business transactions through generations, leading to a path dependent fashion in FDI flows between China and the rest of the world. This study shows Chinese transnational communities, although historically initiated within certain locations during the Treaty Port Era, are nowadays more group identities with informal institutional elements, such as shared meanings, codes of conducts, and economic rationales, developed, diffused and inherited across generations to bind the Chinese diaspora and persistently promote inward FDI flows. Makino and Tsang's (2011) study showed historical informal ties between countries create a path that affects firms' entry decisions and mainly focused on the direct historical relationships between a focal country (Vietnam) with other countries. This present study extends their study by proposing institutional explanations for this phenomenon. In addition, this study goes beyond their country-level analysis by providing a nuanced understanding of how informal institutions formed by transnational ethnic communities create city-level heterogeneity by affecting inward FDI to contemporary local firms.

Second, this study enriches the understanding of the mechanisms by which historical informal institutions affect international business activities by demonstrating how they facilitate the morphing of formal institutions. Previous research has not sufficiently explored whether and how formal trade rules and policies might be internalized and evolve into informal rules that continuously affect contemporary FDI. This study elucidates the underlying mechanism by showing the *mediation* effect of such informal institutions. The findings suggest treaty port policies have boosted the emergence and development of ethnic Chinese transnational communities because these formal rules helped constitute agency, economic rationality, and accountability within them. Such communities carry strong behavioral norms and *guanxi* practice, which they use to then internalize and legitimize externally imposed formal rules by adopting, adapting, and diffusing international trade laws, regulations, and business practices. Much of the

discussion regarding formal and informal institutions has suggested the *moderation* effect *when* one substitutes or complements the other in guiding economic and social interactions (Helmke & Levitsky, 2004). For example, the substitute perspective argues formal and informal institutions can override each other when they are functionally equivalent (Helmke & Levitsky, 2004; Li et al., 2019; Xin & Pearce, 1996). The complementary perspective argues they can complement each other when one of them is less effective (Holmes et al., 2013; Poppo & Zenger, 2002). This study moves beyond this discussion by exploring the mechanisms of how, despite historical disruptions, informal institutions help sustain the influence of formal institutions on international business activities. This occurs when historical formal institutions gradually morph and evolve into an informal one over time, thus functioning as an "institution-in-action" (Suchman & Edelman, 1996: 941), and the informal institutions develop internalizing and diffusive power, thus consolidating the path dependent trajectory in channeling inward FDI.

Finally, findings from the Chinese context offer implications for understanding the enduring effects of informal institutions during institutional upheavals in emerging markets and transitional economies. Extant research demonstrates formal colonial ties continue to have enduring effects on business activities, even after those ties were broken (Greif, 1993; Greif, 1989; Makino & Tsang, 2011). Other studies have suggested the continuous effects of transnational communities on business activities in other emerging markets, such as Vietnam, India, and Malaysia (Bagwell, 2015; Jones & Khanna, 2006; Saxenian, 2002). Although traumatic shocks are featured in emerging markets and transnational economies (Roth & Kostova, 2003), we know little about how political events commonly seen in emerging markets and transitional economies might disrupt such legacies.

Incorporating Klüppel et al.'s (2018) and Pierce and Snyder's (2018) suggestions, this study examined how political traumatic shock alters institutional legacies. The results show compared to the disruptive effect of political shock on formal institutional legacy, informal institutions created and maintained by transnational communities can be reactivated in a new period due to cultural familiarity

and ethnic affinity, and they can compensate for the absence and weakness of a formal institutional framework (Helmke & Levitsky, 2004). In addition, this study also contributes to the understanding of regional variations of inward FDI distribution in emerging economies and transitional economies (Meyer, Estrin, Bhaumik & Peng, 2009; Meyer & Nguyen, 2005). Although local governments in many of these regions that may have experienced colonialism, political traumatic shock, or recent institutional development have provided policy support and economic incentives, certain regions still fail to attract FDI (Wang, 2000; X. Wang, 2013; Xu, 2011). This is probably due to a lack of historical informal institutions to lay the ground for investment activities to take place.

Limitations and future research

This study suggests several future research directions. First, qualitative evidence and field surveys are needed to better substantiate the theoretical model in this study. This study resonates with Pierce and Snyder's (2018) study by using modern firm data to examine the roles of historical events and negative shocks in affecting country-level financial resource access; however, the causal relationship between historical persistence and modern outcome needs to be explored with microlevel research (Felin, Foss & Ployhart, 2015). For example, future research could employ mixed methods (Kaplan, 2015) to explore the microprocess of motivation and decision making for investment location choice.

Second, because of data availability, the measurement of the overseas Chinese community as a dummy variable is only the first step to examining its effect. Cities with overseas Chinese communities vary in numbers of emigrants and overseas connections; thus, further research could develop a more sophisticated analysis when more refined data become available. Third, our measurement of the Cultural Revolution was affected by the lack of systematic data collection during that period of institutional disorder. It thus might be considered coarse, and there may be valid questions about its accuracy. It would be ideal to establish more direct measures; however, because it was a decade-long period of political, social, and economic upheaval, we know of no detailed information indicating the extent of sabotage of, and antagonism toward, foreign firms and residents at that time. Because rates of both population change

and illiteracy capture the magnitude of the Cultural Revolution's effects to some extent, they are appropriate measures given such data limitations, but future research should examine in more detail these processes in specific cities if relevant data are available.

Finally, it would be worthwhile to substantiate the effects of formal and informal institutional legacies and their interplay on contemporary FDI and other international business activities in contexts such as emerging markets and transitional economies that have been influenced by both history and institutional change (Bevan, Estrin, & Meyer, 2004; Jones & Khanna, 2006; Meyer, 2001).

Conclusion

This study examines how institutional legacies, particularly informal ones, exert a continuous influence on contemporary international business activities by combining rational choice institutionalism and the path dependence perspective. It shows Chinese cities' experiences in the Treaty Port Era have left both formal and informal institutional legacies that persistently affect local firms when attracting inward FDI in the contemporary period. It further shows how the Cultural Revolution's influence has altered these legacy effects. This study stimulates future research into understanding the role historical informal institutions play in shaping geographic distribution of international business activities. It also fosters the recognition that locales such as cities not only perpetuate history but also can alter the negative effects of the major political shift because informal institutions carried on by transnational ethnic communities have great survival tenacity.

Furthermore, this study sheds light on the mechanisms by which informal institutions translate and internalize formal rules into norms and customs that persistently affect international business activities by contributing to international business scholars' growing interest in elaborating the mechanisms that underpin the relationships between formal and informal institutions (Holmes et al., 2013; Seyoum, 2011). It also has broader implications for understanding the enduring effect of informal institutions in contexts where institutional upheavals have taken place.

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Table 1. Variable definition, data source, and computation

Variable category	**Definition**	**Data source**	**Computation**
Dependent variable	Inward foreign direct investment	Annual Industrial Survey	Likelihood of investment (1 = yes) Logarithm of the investment value
Independent variables	Treaty port policy Overseas Chinese community	Chinese Maritime Customs data, and published books, articles	With treaty port policy (1 = yes) With overseas Chinese community (1 = yes)
Moderator	Cultural Revolution	Population Censuses	Population change from 1964 to 1982 (reversed) Illiteracy rate (robustness)
Control variables —firm level	Firm size	Annual Industrial Survey	Logarithm of total assets Logarithm of number of employees (robustness) Logarithm of total sales (robustness)
	Financial leverage		Total liabilities over total assets
	Asset tangibility		Tangible assets over total assets
	Firm age		Years since founding
Control variables —industry level	Industry-level inward FDI		Average industry level of inward FDI (excluding focal firm)
	Industry-level innovation		Average industry level innovation
Control variables —city level	Gross Domestic Product (GDP)	China Regional Yearbooks China City Statistical Yearbooks	Logarithm of GDP
	Population		Logarithm of population
	Inflation rate		Consumer price index
	Labor cost		Logarithm of average wage
	Openness of the economy		Sum of imports and exports relative to total GDP
	Green coverage		Percentage ratio of greenery area to total city area
	Urban center		Whether the city has an urban center (1 = yes)
	Length of roads		Logarithm of total length of roads
	Coastal city		Whether the city is located on the coast (1 = yes)
	Canal city		Whether the city is located on a canal (1 = yes)
	Airport presence		With an airport in the city (1 = yes)

Table 2. Summary statistics and correlation matrix (n = 206,187)

Variable	Mean	Std Dev.	1	2	3	4	5	6	7	8	9	10	11	12	13
1. Foreign investment (0/1)	0.622	0.485													
2. Foreign investment (amount)	9.202	11.310	0.217												
3. Treaty port policies	0.472	0.499	0.485	-0.105											
4. Overseas Chinese community	0.628	0.483	0.539	-0.326	0.192										
5. Cultural Revolution	0.347	0.858	-0.144	0.115	-0.101	-0.143									
6. Firm size	10.462	1.368	-0.004	0.051	0.022	0.013	-0.014								
7. Financial leverage	0.496	0.256	-0.017	0.035	0.011	-0.025	-0.012	0.069							
8. Asset tangibility	0.731	0.430	0.433	0.337	-0.001	-0.022	-0.004	-0.059	0.022						
9. Firm age	8.542	5.411	-0.076	-0.112	-0.005	0.069	-0.037	0.154	-0.018	-0.247					
10. Industry-level inward FDI	9.177	4.686	0.309	0.340	0.004	-0.081	0.019	0.010	0.023	0.141	-0.202				
11. Industry-level innovation	2.253	2.594	0.204	0.194	0.012	-0.015	-0.006	0.087	0.020	0.314	-0.002	0.473			
12. GDP	7.493	0.895	0.120	-0.196	0.398	0.200	-0.172	0.082	0.011	-0.301	0.179	-0.242	0.071		
13. Population	6.111	0.515	0.025	0.095	0.304	-0.204	0.107	-0.030	-0.009	0.022	-0.059	0.044	0.046	0.285	
14. Inflation rate	112.726	9.805	0.027	0.040	0.056	-0.045	0.003	0.009	0.012	0.087	0.049	0.109	0.226	0.149	0.050
15. Labor cost	10.052	0.597	-0.077	-0.155	0.148	0.097	-0.063	0.072	0.008	-0.377	0.201	-0.289	0.086	0.483	-0.025
16. Openness of the economy	4.424	4.261	0.223	0.054	0.313	0.031	0.004	-0.023	0.000	0.214	-0.113	0.198	0.048	0.168	0.323
17. Urban center	0.600	0.490	0.000	0.000	0.003	0.002	0.001	-0.001	-0.003	0.002	0.001	0.000	0.002	0.002	0.004
18. Length of roads	9.073	0.667	-0.130	0.111	0.080	-0.339	0.185	-0.033	-0.005	-0.009	-0.091	0.036	0.080	0.017	0.404
19. Airport presence	0.639	0.480	-0.001	-0.005	0.002	0.001	0.001	-0.003	0.000	-0.001	0.003	0.000	-0.001	0.002	-0.006
20. Coastal city	0.398	0.489	0.209	-0.123	0.272	0.181	-0.163	-0.074	-0.030	-0.007	0.032	-0.034	-0.018	0.339	0.159
21. Canal city	0.161	0.367	-0.143	0.188	-0.006	-0.147	-0.036	0.062	0.026	-0.029	-0.056	0.011	0.016	0.135	0.032
22. R&D intensity	0.000	0.003	0.038	0.059	0.013	-0.008	-0.006	0.105	0.001	0.098	0.024	0.100	0.241	0.024	0.002
23. Profitability	0.071	0.131	-0.042	0.000	0.027	-0.054	0.030	-0.030	-0.200	-0.027	-0.039	-0.015	0.027	0.031	0.111
24. Industry competitiveness	0.089	0.083	0.603	-0.090	0.299	0.284	-0.075	0.032	-0.006	0.309	-0.086	0.208	0.011	-0.026	0.009
25. Industry sales growth	0.065	0.053	0.899	-0.182	0.435	0.477	-0.128	-0.001	-0.013	0.405	-0.077	0.298	0.174	0.095	0.021

Variable	14	15	16	17	18	19	20	21	22	23	24	25
14. Inflation rate												
15. Labor cost	0.192											
16. Openness of the economy	0.057	-0.065										
17. Urban center	0.003	0.000	-0.001	-0.001								
18. Length of roads	0.115	-0.036	0.217	-0.088	0.000							
19. Airport presence	0.001	0.001	0.002	0.001	0.004	-0.005						
20. Coastal city	-0.023	0.126	0.134	0.293	0.001	-0.113	0.002					
21. Canal city	0.045	0.068	0.127	0.199	-0.001	0.065	0.001	-0.349				
22. R&D intensity	0.039	0.031	0.014	0.025	0.003	-0.001	-0.001	0.016	-0.011			
23. Profitability	0.060	0.015	0.043	0.045	0.005	0.107	0.000	0.063	0.008	0.032		
24. Industry competitiveness	-0.090	-0.178	0.141	0.127	0.003	-0.115	-0.002	0.108	-0.089	0.017	-0.031	
25. Industry sales growth	0.039	-0.075	0.197	0.194	-0.001	-0.120	0.000	0.184	-0.128	0.036	-0.037	0.468

Table 3. Quality of the propensity score matching (PSM)

	Multinomial logit regression results			Pre-matching	Post-matching
Variance	Treaty port coef/se	Overseas community coef/se	Both coef/se	Differences (p value) between variables/ % bias	Differences (p value) between variables/ % bias
Firm size	-0.075	-0.116	-0.093	<0.000	0.77
	(0.008)	(0.007)	(0.008)	46.89	4.95
Financial leverage	-0.309	-0.631	-0.051	<0.000	0.9
	(0.043)	(0.039)	(0.041)	38.69	3.84
Asset tangibility	-0.838	-0.741	-2.582	<0.000	0.75
	(0.058)	(0.053)	(0.054)	25.66	1.97
Firm age	0.008	0.026	-0.001	<0.000	0.79
	(0.002)	(0.002)	(0.002)	98.89	4.72
Industry level	-0.043	-0.135	-0.065	<0.000	0.63
inward FDI	(0.004)	(0.004)	(0.004)	47.09	3.3
Industry level	-0.083	0.052	0.061	<0.000	0.53
innovation	(0.007)	(0.006)	(0.006)	14.86	2.75
GDP	3.231	2.172	1.579	<0.000	0.65
	(0.030)	(0.025)	(0.024)	19.11	3.35
Population	-2.824	-3.086	0.982	<0.000	0.88
	(0.057)	(0.047)	(0.051)	101.28	2.29
Inflation rate	-0.009	-0.013	0.003	<0.000	0.38
	(0.002)	(0.001)	(0.001)	97.06	3.24
Labor cost	-1.876	-1.855	-0.123	<0.000	0.24
	(0.045)	(0.044)	(0.036)	51.14	4.33
Openness of the	0.047	-0.055	0.109	<0.000	0.57
economy	(0.003)	(0.003)	(0.003)	23.97	2.16
Urban center	0.026	0.030	0.043	<0.000	0.17
	(0.022)	(0.020)	(0.021)	105.19	1.72
Length of road	1.561	-0.410	-2.785	<0.000	0.78
	(0.045)	(0.034)	(0.037)	45.8	1.88
Airport presence	-0.010	-0.038	-0.006	<0.000	0.23
	(0.023)	(0.021)	(0.021)	84.64	4.75
Coastal city	0.121	0.232	0.572	<0.000	0.35
	(0.029)	(0.027)	(0.028)	86.6	1.43
Canal city	-30.311	-34.436	-1.481	<0.000	0.48
	(1,425.096)	(1,389.599)	(0.034)	83.67	4.68
R&D intensity	-39.266	-48.635	-34.876	<0.000	0.86
	(4.747)	(4.424)	(4.328)	25.41	3.48
Profitability	-0.899	-0.910	-0.102	<0.000	0.51
	(0.079)	(0.073)	(0.075)	37.13	3.98
Industry	4.285	-0.296	4.889	<0.000	0.78
competitiveness	(0.166)	(0.180)	(0.158)	28.64	2.12
Industry sales	38.829	41.084	56.351	<0.000	0.67
growth	(0.337)	(0.308)	(0.326)	16.29	2.78
intercept	-1.090	29.293	8.612		
	(0.488)	(0.439)	(0.393)		
Number of observations		206,187		Mean bias before matching: 16.4	
Adjusted R2		0.468		Mean bias after matching: 4.6	
chi2			257506.41	Pseudo-R^2 after matching: 0.010	

Table 4. Heckman model for treaty ports and overseas Chinese communities on firms' FDI (1998 to 2013)

Dependent variable	Likelihood of FDI			Overseas Chinese community	Likelihood of FDI			Amount (logarithm of) FDI					
Random effect	**Probit**			**Linear**	**Probit**			**Linear**					
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**
Firm size	-0.014	-0.015	0.002	0.006	0.009	0.015	0.012	-0.005	-0.012	0.001	0.002	-0.001	-0.000
	(0.007)	(0.008)	(0.006)	(0.002)	(0.006)	(0.006)	(0.006)	(0.005)	(0.003)	(0.001)	(0.001)	(0.001)	(0.001)
Financial leverage	-0.123	-0.175	-0.139	-0.163	-0.138	-0.119	-0.130	0.573	0.145	-0.005	-0.001	-0.009	-0.007
	(0.040)	(0.039)	(0.031)	(0.012)	(0.032)	(0.032)	(0.032)	(0.024)	(0.014)	(0.004)	(0.004)	(0.004)	(0.004)
Asset tangibility	0.911	1.296	2.425	0.598	2.435	2.428	2.437	-3.603	-1.562	0.031	0.016	0.016	-0.012
	(0.042)	(0.046)	(0.038)	(0.015)	(0.041)	(0.040)	(0.041)	(0.031)	(0.018)	(0.006)	(0.006)	(0.006)	(0.006)
Firm age	-0.000	0.002	-0.000	0.005	-0.001	-0.000	-0.001	-0.018	-0.003	0.000	0.000	-0.000	0.000
	(0.002)	(0.002)	(0.002)	(0.001)	(0.002)	(0.002)	(0.002)	(0.001)	(0.001)	(0.000)	(0.000)	(0.000)	(0.000)
Industry-level inward FDI	-0.025	-0.030	-0.002	-0.044	0.001	0.001	0.001	0.035	-0.011	0.000	0.001	-0.000	0.001
	(0.003)	(0.003)	(0.003)	(0.001)	(0.003)	(0.003)	(0.003)	(0.002)	(0.001)	(0.000)	(0.000)	(0.000)	(0.000)
Industry-level innovation	0.028	0.032	0.041	-0.003	0.044	0.042	0.043	0.046	0.041	0.000	0.001	0.001	0.002
	(0.005)	(0.005)	(0.004)	(0.002)	(0.005)	(0.005)	(0.005)	(0.003)	(0.002)	(0.001)	(0.001)	(0.001)	(0.001)
GDP	0.343	0.258	0.120	0.521	0.109	0.139	0.123	-0.355	-0.306	-0.003	-0.005	-0.015	-0.026
	(0.016)	(0.017)	(0.014)	(0.007)	(0.015)	(0.015)	(0.015)	(0.012)	(0.007)	(0.002)	(0.002)	(0.002)	(0.002)
Population	-0.154	-0.436	-0.442	-0.415	-0.376	-0.443	-0.391	3.586	1.053	0.008	-0.005	0.033	0.028
	(0.039)	(0.040)	(0.033)	(0.015)	(0.035)	(0.034)	(0.035)	(0.027)	(0.017)	(0.005)	(0.005)	(0.006)	(0.005)
Inflation rate	-0.004	-0.005	-0.006	-0.007	-0.008	-0.007	-0.008	0.016	0.005	0.000	0.000	0.000	0.000
	(0.001)	(0.001)	(0.001)	(0.000)	(0.001)	(0.001)	(0.001)	(0.001)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Labor cost	-0.054	-0.082	-0.032	-0.054	-0.026	-0.014	-0.022	0.503	0.209	0.001	0.004	0.001	0.006
	(0.017)	(0.018)	(0.019)	(0.007)	(0.020)	(0.019)	(0.019)	(0.013)	(0.007)	(0.002)	(0.002)	(0.002)	(0.002)
Openness of the economy	0.031	0.011	0.015	0.019	0.016	0.014	0.016	0.093	0.013	0.000	0.000	0.000	-0.000
	(0.003)	(0.003)	(0.003)	(0.001)	(0.003)	(0.003)	(0.003)	(0.001)	(0.001)	(0.000)	(0.000)	(0.000)	(0.000)
Urban center	-0.002	-0.003	-0.015	0.003	-0.017	-0.017	-0.017	0.019	0.010	-0.000	0.000	0.000	0.001
	(0.020)	(0.020)	(0.016)	(0.006)	(0.017)	(0.016)	(0.017)	(0.012)	(0.007)	(0.002)	(0.002)	(0.002)	(0.002)
Length of roads	-0.073	0.055	0.344	-0.895	0.358	0.278	0.329	-2.385	-1.132	-0.005	-0.023	-0.002	-0.024
	(0.028)	(0.029)	(0.024)	(0.011)	(0.025)	(0.024)	(0.025)	(0.019)	(0.012)	(0.004)	(0.004)	(0.004)	(0.004)
Airport presence	-0.009	-0.012	-0.010	-0.005	-0.010	-0.010	-0.010	0.021	0.004	-0.001	-0.001	-0.001	-0.001
	(0.021)	(0.021)	(0.016)	(0.006)	(0.017)	(0.017)	(0.017)	(0.013)	(0.007)	(0.002)	(0.002)	(0.002)	(0.002)
Coastal city	0.097	0.002	0.060	0.021	0.115	0.056	0.107	0.331	0.160	0.006	-0.005	0.011	-0.002
	(0.026)	(0.027)	(0.020)	(0.008)	(0.021)	(0.021)	(0.021)	(0.015)	(0.009)	(0.003)	(0.003)	(0.003)	(0.003)
Canal city	-0.368	-0.435	-0.079	-0.756	0.013	-0.043	0.003	2.245	1.226	0.017	0.022	0.028	0.040
	(0.029)	(0.032)	(0.027)	(0.010)	(0.028)	(0.028)	(0.028)	(0.023)	(0.013)	(0.004)	(0.004)	(0.004)	(0.004)
R&D intensity	-8.769	-9.679	1.453		3.196	4.448	3.443						
	(4.043)	(4.239)	(3.422)		(3.855)	(3.747)	(3.874)						
Profitability	-0.301	-0.337	-0.276		-0.296	-0.318	-0.306						
	(0.079)	(0.079)	(0.062)		(0.063)	(0.063)	(0.063)						
Industry competitiveness	4.693	4.265	4.540		5.264	5.116	5.341						
	(0.076)	(0.079)	(0.079)		(0.086)	(0.085)	(0.087)						
Industry sales growth	43.749	41.123	22.548		24.565	23.837	24.786						
	(0.151)	(0.156)	(0.138)		(0.174)	(0.162)	(0.178)						
Treaty port policies		1.064	1.963	0.242	1.862	1.972	1.888		4.632	5.997	5.994	5.931	5.894
		(0.030)	(0.023)	(0.008)	(0.025)	(0.024)	(0.026)		(0.009)	(0.003)	(0.003)	(0.004)	(0.004)
Overseas Chinese community			2.150		2.154	1.974	2.099			4.000	3.949	4.007	3.939
			(0.022)		(0.024)	(0.024)	(0.026)			(0.004)	(0.004)	(0.004)	(0.004)
Cultural Revolution					-0.091	-0.124	-0.112				0.069	0.134	0.296
					(0.012)	(0.012)	(0.012)				(0.003)	(0.005)	(0.005)
Treaty port Cultural Revolution					-0.635		-0.531				-0.285		-0.408
					(0.024)		(0.032)				(0.007)		(0.007)
Overseas Chinese community						0.451	0.160					0.216	0.327
Cultural Revolution						(0.020)	(0.027)					(0.006)	(0.006)
Inverse Mills ratio								-33.833	-19.602	1.475	1.297	1.081	0.639
								(0.190)	(0.115)	(0.042)	(0.043)	(0.044)	(0.044)
Intercept	-2.828	-1.595	-5.635	8.461	-6.078	-5.331	-5.895	14.450	14.674	-0.463	-0.251	-0.473	-0.183
	(0.241)	(0.246)	(0.236)	(0.094)	(0.247)	(0.241)	(0.249)	(0.172)	(0.101)	(0.035)	(0.036)	(0.036)	(0.035)
Number of observations	162,067	162,067	162,067	162,067	162,067	162,067	162,067	102,361	102,361	102,361	102,361	102,361	102,361
Chi2	232,703.301	234,659.038	244,692.418	55,222.675	245,787.005	245,483.405	245,858.167	0.472	0.818	0.981	0.981	0.981	0.982

Note: Standard errors are in parentheses.

Table 5. Random-effects linear model for location-based FDI attraction (1998 to 2013)

Dependent variable	Logarithm of foreign investment by:					
	US	**Russia**	**Germany**	**Japan**	**France**	**UK**
Treaty port opened by						
US	1.264	0.415	0.008	0.471	0.022	0.072
	(0.008)	(0.008)	(0.008)	(0.009)	(0.008)	(0.009)
Russia	0.027	0.865	-0.006	-0.283	0.002	-0.044
	(0.006)	(0.006)	(0.006)	(0.006)	(0.006)	(0.007)
Germany	-0.038	-0.040	0.942	-0.270	-0.013	-0.281
	(0.005)	(0.005)	(0.005)	(0.005)	(0.005)	(0.006)
Japan	0.009	0.014	0.028	1.213	0.008	-0.020
	(0.003)	(0.003)	(0.003)	(0.004)	(0.003)	(0.004)
France	0.010	0.011	0.071	0.019	1.407	0.159
	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)
UK	0.024	0.025	0.020	0.075	0.025	1.209
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.003)
Ancestral hometown to Chinese offspring in						
US	0.108	-0.001	-0.002	-0.004	-0.001	0.003
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Russia	-0.004	0.105	0.000	-0.003	0.001	-0.001
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Germany	-0.002	0.002	0.105	-0.000	0.000	0.001
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Japan	0.002	0.000	-0.002	0.108	-0.000	-0.002
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
France	-0.002	-0.002	0.000	0.001	0.107	0.003
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
UK	-0.004	0.003	-0.004	0.002	-0.004	0.107
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Firm size	0.000	-0.001	0.000	0.004	0.000	-0.001
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Financial leverage	-0.005	-0.005	0.004	-0.016	0.004	0.019
	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)
Asset tangibility	-0.009	-0.012	-0.037	-0.029	0.000	-0.121
	(0.005)	(0.005)	(0.005)	(0.005)	(0.005)	(0.006)
Firm age	-0.000	0.000	-0.001	0.000	-0.000	-0.001
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Industry level inward FDI	-0.000	0.001	-0.000	-0.001	-0.001	0.002
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Industry level innovation	0.000	0.000	0.002	0.002	0.000	0.001
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.001)
GDP	0.003	0.002	-0.002	-0.014	0.002	-0.008
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Population	0.016	0.016	-0.027	0.058	0.003	0.223
	(0.005)	(0.005)	(0.005)	(0.005)	(0.005)	(0.005)
Inflation rate	0.000	-0.000	0.000	0.000	-0.000	0.001
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Labor cost	0.003	-0.002	-0.002	0.012	0.002	0.047
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Openness of the economy	0.001	0.001	0.001	0.000	0.000	0.007
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Urban center	0.001	-0.001	-0.001	0.003	0.001	-0.003
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Length of road	-0.013	-0.016	0.001	-0.066	-0.004	-0.177
	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)	(0.004)
Airport presence	-0.001	-0.001	-0.001	-0.000	-0.003	-0.000
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Coastal city	-0.005	-0.006	-0.006	0.041	-0.002	0.070
	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)	(0.003)
Canal city	0.011	0.008	0.001	0.246	0.015	0.029
	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)
intercept	-0.025	0.044	0.190	0.137	-0.030	-0.219
	(0.027)	(0.027)	(0.027)	(0.028)	(0.027)	(0.031)
Number of observations	128,351	128,351	128,351	128,351	128,351	128,351
Adj. R^2	0.251	0.331	0.333	0.725	0.545	0.743

Note: Standard errors are in parentheses.

Figure 1. Proposed theoretical model